

**WRITTEN TESTIMONY OF
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INTERNAL REVENUE SERVICE
BEFORE
HOUSE COMMITTEE ON FINANCIAL SERVICES'
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT
ON
MONEY SERVICE BUSINESSES
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Good morning Chairman Bachus, ranking Member Sanders, and members of the Subcommittee on Financial Institutions and Consumer Credit. My name is Eileen Mayer and I am the Director of Fraud/Bank Secrecy Act (BSA) within the Small Business/Self Employed (SB/SE) division of the Internal Revenue Service (IRS). My office is assigned the responsibility to fulfill IRS' obligations under the Bank Secrecy Act as well as coordinating the establishment of Service-wide fraud strategies, policies, and procedures. My office also provides fraud referral coordination for all operating divisions of the IRS.

IRS' role in administering the BSA is derived from statutory authority given to the Secretary of the Treasury to administer the provisions of the Act. He in turn delegated that authority to the Director of the Financial Crimes Enforcement Network (FinCEN). FinCEN retained some authorities but delegated others. Specifically, the IRS was delegated the authority to examine, for BSA compliance, all financial institutions not currently examined by a Federal functional regulator. These entities include money service businesses (MSBs), such as check cashers, issuers of traveler's checks, and money transmitters, casinos, certain credit unions that are not otherwise regulated by the Federal Government, dealers in jewelry and precious metals and insurance companies.

Emphasis on Customer Service

Under the leadership of Commissioner Everson, the IRS has taken a balanced approach to tax compliance, one that emphasizes service as well as enforcement. Many MSBs are small businesses and in some cases sole proprietorships. As a result, they may not fully understand their responsibilities under the BSA.

An important part of fulfilling our responsibilities under the BSA is to work closely with our office of Communications, Liaison and Disclosure (CLD) to identify those areas where education and outreach efforts can be most productive. We also have BSA outreach specialists located in the six top high risk money laundering and related financial crime areas – Miami, New York, Chicago, Houston, San Francisco, and Los Angeles.

In addition, we are also revising our BSA Internal Revenue Manual and once it is finalized we will make that available to all MSBs – including posting it on the internet so that it is readily available to everyone. We plan to convert the manual to a more user friendly format similar to the manual created by the Federal Financial Institutions Examination Council.

Coordination with Other Groups

In our efforts to assure compliance with the provisions of the BSA, we have been pleased to partner with the other groups represented at the table today. While each of the groups has distinct responsibilities relative to the BSA, we all must work cooperatively to be most effective in monitoring and preventing questionable transactions. As evidence of that cooperation, Commissioner Everson was pleased to announce in late April that we had reached agreements with 33 states and Puerto Rico to begin sharing BSA information. The agreements will allow the IRS and the participating states to share information and leverage their resources to ensure that MSBs are complying with their federal and state responsibilities to register with the government, to create and maintain anti-money laundering programs and to report cash transactions and suspicious activities. This would have not been possible without the support and assistance of the Conference of State Bank Supervisors (CSBS)

In addition, we have a very close working relationship with FinCEN. We have a memorandum of understanding in place which provides for exchanges of information to help FinCEN fulfill its role as administrator of the BSA and to assist us in conducting examinations of MSBs to assess BSA compliance. IRS and FinCEN work closely on such things as setting examination priorities, review of the BSA Internal Revenue Manual, and training. As I will discuss in more detail later, we also refer all potential BSA civil penalty cases to FinCEN for appropriate action.

IRS Enforcement

In recent years, the IRS has strengthened the focus on enforcement, while maintaining appropriate service to taxpayers. Detecting and investigating money laundering activity is an important part of tax compliance for the IRS. In addition, the failure to file forms required by the BSA and criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, often have a direct link to tax evasion and money laundering. In some cases, because the schemes are sophisticated and because we may not be able to obtain evidence from some foreign countries, it is almost impossible to conduct traditional tax investigations. In these circumstances, money-laundering violations frequently are the only possible means to detect tax evaders.

Money laundering not only is used by domestic and international criminal enterprises to conceal the illegal, untaxed proceeds of narcotics trafficking, arms trafficking, extortion, public corruption, terrorist financing, and other criminal activities; it is also an essential element of many tax evasion schemes. With the globalization of the world economy and financial systems, many tax evaders exploit domestic and

international funds transfer methods to hide untaxed income. These schemes often involve the same methods to hide money from illegal sources and to hide unreported income. Both activities generally use nominees, wire transfers, multiple bank accounts, and international “tax havens” to avoid detection.

Money laundering is the financial side of virtually all crime for profit. To enjoy the fruits of their crime, criminals must find a way to insert the illicit proceeds of that activity into the stream of legitimate commerce in order to provide the resources necessary for criminal organizations to conduct their ongoing affairs.

IRS’ Role in BSA Compliance

As part of its core tax administration mission, the IRS addresses both the civil and criminal aspects of money laundering. On the civil side, the Department of the Treasury, through FinCEN, has delegated to the IRS responsibility for ensuring compliance with the BSA for all non-banking financial institutions not otherwise subject to examination by another federal functional regulator, including MSBs.

Under this FinCEN delegation, the IRS is responsible for three elements of compliance: – (i) the identification of MSBs, (ii) educational outreach to all these types of organizations, and (iii) the examination of those entities for compliance.

Currently, there are over 24,000 MSBs registered and posted on the FinCEN website. However because the true universe of potential MSBs is unknown, we utilize several methods to identify unregistered MSBs. One method is to utilize information from the states that identifies businesses that are registered at the state level but not with FinCEN. We also review our Currency Banking and Retrieval System (CBRS) data base to discover suspicious activity reports (SARs) or currency transaction reports (CTRs) that emanate from entities that should be registered. We also get leads from other Federal agencies such as Immigration and Customs Enforcement. Finally, we receive anecdotal reports on entities that are not registered but who are doing check cashing or other financial activities that would subject them to registration requirements

Through these various means, we have identified more than 2,000 cases of businesses not registering as required under the BSA and we will be pushing these cases to the field shortly.

Our outreach program is designed to reach both registered and unregistered MSBs. We focus special attention on those industries where FinCEN has issued a threat alert. For example, currently we are working with the convenience stores owners and gasoline retailers, many of whom are MSBs and may not even realize it. We work closely with the trade associations that represent specific MSBs making sure they understand the requirements that their members face. We also make ourselves available for seminars at association events and as exhibitors at their trade shows. We also look at industries where we suspect that there may be high incidences of non-registration and work closely with them to make sure they understand the registration requirements.

From a criminal perspective, IRS' Criminal Investigation (CI) Division is responsible for the criminal enforcement of BSA violations and money laundering statutes related to tax crimes. CI uses the BSA and money laundering statutes to detect, investigate, and prosecute criminal conduct related to tax administration, such as abusive schemes, offshore tax evasion, and corporate fraud. CI also investigates the non-filing of BSA forms and criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, which frequently have a direct link to both tax evasion and money laundering.

The IRS CI Division has increased its emphasis on BSA responsibilities significantly, with particular focus on improving the effectiveness and efficiency of Suspicious Activity Report (SAR) Review Teams. CI now hosts approximately 80 SAR Review Teams located throughout its 30 Criminal Investigation field offices. These teams are made up of federal, state and local law enforcement officials and work closely with Assistant United States Attorneys. The expansion in the number of teams improves analysis of SARs because each team can focus on the geographical area with which it is most familiar. Increased use of technology, primarily data-mining tools, is assisting teams in efficiency analyzing the ever increasing number of SARs being filed.

MSB Compliance

The BSA imposes several requirements on money service businesses. These include:

- The development and implementation of an adequate Bank Secrecy Act or Anti-Money Laundering (AML) program. An effective program is one that is reasonably designed to prevent the money service business from being used to facilitate money laundering and the financing of terrorist activities. Such a plan must include the following elements: (a) a system of internal controls to assure compliance; (b) the designation of an individual responsible for coordinating and monitoring day-to-day compliance; (c) the provision of training for appropriate personnel; and (d) the provision for independent review to monitor and maintain an adequate program.
- A requirement that MSBs file a report of each deposit, withdrawal, exchange of currency or other payments or transfer which involves a transaction of currency of more than \$10,000; and
- A requirement that "suspicious transactions" be reported. The BSA and its implementing regulations have defined what might be classified as a suspicious transaction. They include such things as transactions that involve funds gained from illegal activities or designed to evade reporting or recordkeeping requirements under the BSA, or transactions in which the particular customer would normally not engage.

IRS Examinations

It is important to point out that all of our BSA examiners and their managers devote 100 percent of their examination time to examinations of BSA-related cases. This contrasts with our efforts in 2004 and before when BSA work was a collateral duty of revenue agents who were engaged in traditional income tax audits.

In choosing which MSBs to examine, we are utilizing a centralized case selection process. The Treasury Inspector General for Tax Administration (TIGTA) has previously scrutinized our work selection process observing that current processes create a significant risk of undetected non-compliance and inconsistent program delivery. As a result we are developing a systematic, risk-based inventory selection process. This process is based on a scoring system that uses data from the Currency and Banking Retrieval System (CBRS) to identify the best candidates for examination. We are currently field testing that scoring system.

Once we identify a particular MSB for examination, our first step is to request from the entity a copy of its anti-money laundering compliance program and a copy of the independent audit of the compliance program. The examiner will then prepare a risk based assessment that essentially determines the scope of the rest of the examination.

During the course of the exam, the examiner will identify the entity's AML risks, evaluate policies, procedures, and internal controls and assess whether breakdowns in the AML compliance program place the institution at risk for money laundering. We will then perform selective transactional testing.

Upon completion of the examination one of four outcomes will occur. First, if no violations are found, we will issue what we call Letter 4029 which gives the entity documentation that a review has occurred and that no violations were identified. This is important because we are well aware that many MSBs are facing increasing difficulty in finding banks willing to do business with them. These banks, both large and small, seem to believe that opening new or maintaining existing accounts for money service businesses will be too costly, pose a potential threat to their reputation, or expose them to greater regulatory scrutiny.

This is regrettable. The money services business industry provides valuable financial services, especially to individuals who may not have ready access to the formal banking sector. It is long-standing Treasury policy that a transparent, well regulated money services business sector is vital to the health of the world's economy. It is important that money services businesses that comply with the requirements of the Bank Secrecy Act and applicable state laws remain within the formal financial sector, subject to appropriate anti-money laundering controls.

It is equally important to ensure that the money services business industry maintains the same level of transparency, including the implementation of a full range of anti-money laundering controls required by law, as do other financial institutions. If account relationships are terminated on a wide-spread basis, we believe many of these businesses could go "underground." This potential loss of transparency would significantly damage

our collective efforts to protect the U.S. financial system from money laundering and other financial crime – including terrorist financing.

The second possible outcome of an examination would be the issuance of a Letter 1112 (L-1112). The L-1112 would be issued if violations are found, but they are technical, minor, infrequent, isolated, and non-substantive. This letter will detail the violations and ask that the entity commit to correct the apparent violations. It also provides the business with the opportunity to disagree with the findings and to provide us within 30 days, an explanation of any disagreement.

It is important to realize that the issuance of an L-1112 involves no fines or other penalties on the MSB. It merely says that we have found these violations and by signing the letter, the business agrees to correct the deficiencies that were noted.

The third potential outcome of an examination is an instance where a significant BSA violation or deficiency is identified. In this instance, the case is referred to FinCEN for consideration of civil penalties. Examples of this would be if the violation was flagrant, demonstrated bad faith or was committed with disregard for the law or the consequences to the institution. Other factors in considering whether to refer a matter to FinCEN include: (a) the frequency of the violation; (b) whether the violation is intentionally concealed; (c) whether the business fails to cooperate in correcting the violation; and, (d) the history of prior violations and/or poor compliance. Field examiners are given a clear list of criteria to consider in determining whether to refer a case to FinCEN.

Once a case is referred to FinCEN, the IRS is no longer involved. FinCEN will make the determination of what, if any civil penalty is appropriate.

Finally, if the examiner believes that there may be a willful criminal violation involved, the case would immediately be referred to IRS-Criminal Investigations when the relevant facts have been developed. CI will evaluate the case and determine whether the case reaches the level of criminal behavior and meets certain minimum case selection criteria. From a legal perspective, one of the most difficult issues facing CI in deciding if a case is worthy of a criminal investigation is documenting sufficient evidence of affirmative acts to establish willfulness. Willfulness can be difficult to prove and when dealing with the Bank Secrecy Act violations it often requires documenting a subject's knowledge of their obligations under the BSA.

From a practical perspective, case selection is another key factor in determining whether a case will be successfully prosecuted. Our CI division has vast experience in determining the prosecution potential of cases selected for investigation, evidenced by a 96.3% acceptance rate at the Department of Justice and 92.2% acceptance rate at the United States Attorneys Offices for Fiscal Year 2005.

If CI makes the determination that they will not refer the case to the Department of Justice for review, it comes back to us and we decide whether to then refer it to FinCEN for consideration of possible civil penalties.

If an MSB believes that an examiner has made a mistake in his or her assessment of potential violations, there is recourse. As noted above, if the MSB is issued an L-1112 letter, it has 30 days in which to respond explaining why the examiner is wrong. The MSB can also elevate the issue to the BSA Territory Manager or contact FinCEN through their hot line number posted on their website.

To give you an idea of the universe of cases we audit, in FY 2005, we examined 3,680 MSBs. We issued L-1112 violation letters to 1,337 of these. We referred 21 cases for criminal investigation and referred 7 cases to FinCEN.

As of May 26 of this fiscal year, we have examined 3,668 MSBs and issued violation letters to 2,414 entities. We have also issued 1241 Letters 4029, indicating clean examinations. We have referred 10 cases to CI and 3 cases to FinCEN.

One of the questions raised by the subcommittee's staff prior to this hearing was whether our field examiners ever provide feedback to the principal when we complete the exam of an MSB agent. We do not. We have discussed this issue with FinCEN and the problem comes down to the possibility of making unauthorized disclosures. The fact is that many MSBs offer multiple services as agents for more than one principal. For example, an MSB might issue both American Express and Visa traveler's checks. Or, the MSB may transmit money as an agent of Western Union and also sell money orders as an agent of MoneyGram. By informing one principal of violations, we may be making an unauthorized disclosure involving other principals. Therefore, FinCEN has required that we not provide any feedback to an agent's principal(s).

Conclusion

As I stated earlier in this testimony, the fight against money laundering and terrorist financing are top priorities for the Internal Revenue Service. We are prepared to increase our commitment to the BSA Program, and we will continue to coordinate our efforts closely with FinCEN and the other groups represented here this morning.

We will also not forget the importance of assisting MSBs whenever possible in understanding and complying with their responsibilities under the BSA. As Commissioner Everson has said often, service plus enforcement equals compliance.

Mr. Chairman, I thank you for this opportunity to appear before you this morning and will be happy to respond to any questions that you or members of the Subcommittee may have.